

## NAIC Update Summer 2013



### Top stories

- International pressure affects U.S. regulators
- Reinsurance collateral reductions on track
- Group supervision ICP causes concern
- Corporate governance changes move to completion
- Issues raised with contract exposure drafts

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- December 15-18: NAIC Fall National Meeting; Washington, DC

# Regulators meet amidst a gathering storm

**Indianapolis, IN** — Envisioning a place of safety in difficult times, troubadour Bob Dylan once sang:

*Try imagining a place where it's always safe and warm  
"Come in," she said. "I'll give you shelter from  
the storm."*

Like Dylan in "Shelter from the Storm," state insurance regulators meeting in Indianapolis for the summer national meeting of the National Association of Insurance Commissioners (NAIC) may be forgiven for feeling a bit besieged by the outside world. Despite its relatively good performance during the 2008 financial crisis, the system of state-based insurance regulation represented by the assembled commissioners and superintendents has been the subject of calls for change both nationally and internationally.

Indianapolis — even in the notoriously nice Midwest, a place where everyone seemed remarkably friendly and welcoming — thus may have been just the right place for the regulators to seek shelter from the storm. For the most part it was, resulting in a meeting best described as calm, despite a few flashes of passion mainly directed at efforts to impose a foreign system of insurance regulation on insurance companies, and some minor, almost amusing sniping among regulators on opposite sides of the life insurance captive issue.

Despite the lack of fireworks, the NAIC's work did go on. Under the leadership of Vermont's Susan Donegan, the organization continued its lightning fast move toward new corporate governance standards.

New reinsurance collateral rules continued their march ahead. Work on the Own Risk and Solvency Assessment (ORSA) stayed on track. In general, the Solvency Modernization Initiative (SMI) stayed on schedule, in stark contrast to the delays plaguing the introduction of the European Solvency II regulatory regime.

Still, there were obvious challenges. New York, one of the largest jurisdictions in the NAIC, had previously served notice of its discontent with the current use of captives

by life insurers. Along with another large jurisdiction, California, and others, New York also opposed the introduction of principle-based reserving (PBR) for life insurance companies, a top priority of the NAIC.

This split on bedrock principles came at a time state regulators and legislators could be said to have reason for concern about the continuation of state insurance regulation in its current form. So the friendly cocktail party banter and polite meeting chatter within could not always block awareness of the storm without.

Federal Insurance Office (FIO) Director, Michael T. McRaith, whose long overdue report on the state of insurance regulation may indicate the federal government's intended direction in the area, spoke behind closed doors to the assembled regulators. According to press reports of the confidential meeting, McRaith served notice again of the FIO's interest in the use of captives by life insurers, and its apparent perception that this use may reflect gaps in state regulation.

Regulators, for the most part, stood firm in their praise of the current state regulatory system, aided by the largest contingent of state insurance legislators ever to attend an NAIC meeting. Led by Connecticut's Thomas Leonardi, regulators repeatedly expressed concern about what could be seen as attempted intrusions by the G-20's Financial Stability Board (FSB) into insurance regulation, most directly through its work with the International Association of Insurance Supervisors (IAIS).

Those concerns may have been proven prophetic when, shortly after the NAIC meeting, the FSB called for centralized insurance regulation in the United States. The FSB's suggestion that "U.S. authorities should carefully consider and provide recommendations to Congress as to whether migration towards a more federal and streamlined structure may be a more effective means of achieving greater regulatory uniformity" may have taken on new urgency in the weeks after the NAIC meeting, when New York announced that it would not participate in the implementation of principle-based reserving.



*Photo courtesy of the NAIC*

Beset by the potential of dissent within and attacks on state regulation from without, the NAIC may well have sent another, even if inadvertent, message in choosing Indianapolis as the host for its national meeting. That city, home to the American Legion, boasts the largest number of war memorials outside of Washington, D.C.

The meeting may have offered only temporary shelter from the storm. The future of insurance regulation remains, for now, under construction, and remarks by many state regulators seemed to indicate they understood that meant, as Dylan said elsewhere, "There's a battle outside, and it is ragin'...For the times they are a-changin'."

# FSB, FSOC not warmly praised

Before hearing from Deloitte subject matter specialists on resolution planning for banks and how that process may be applicable to insurance companies, the Financial Stability (EX) Task Force heard a frank expression of concern about the current international regulatory process from Task Force chair Thomas Leonardi of Connecticut.



Connecticut Commissioner Thomas Leonardi is the sole U.S. regulator representative to the IAIS Financial Stability Committee.

*Photo courtesy of Connecticut Department of Insurance*

For the past three years, Commissioner Leonardi has served as the sole U.S. regulator representative to the Financial Stability Committee (FSC) of the IAIS.

Leonardi spoke of the role of the G-20's FSB, which, though not a regulator, has struck some regulators as apparently moving to a quasi-regulatory role through its instructions to the IAIS and others. Leonardi noted examples of how the FSB could be seen as dictating regulatory actions.

"The FSB was very specific in requesting that the IAIS develop a straightforward backstop capital requirement as a foundation for higher loss absorbency, which means higher capital requirements, as one of the potential measures to be applied to G-SIIs (Global Systemically Important Insurers)," he said. "The IAIS has responded with the formation of an HLA (Higher Loss Absorbency) Drafting Group. This group has a meeting planned for the first week of September in Washington, D.C., including an open session with Observers."

Three U.S. insurers have already been designated as G-SIIs.

The issue of capital standards in ComFrame has been highly contentious, with U.S. regulators and industry standing together opposed to European attempts to impose these standards. The FSB's involvement may affect that standoff.

"More broadly, these new requests from the FSB also called on the IAIS to develop "a comprehensive, group-wide supervisory and regulatory framework," including a quantitative capital standard, that would apply to all internationally active insurance groups which, quite frankly, sounds an awful lot like ComFrame to me!," Leonardi said. "One of my concerns is that we at the IAIS have taken great pains to keep the issues of global capital, systemic risk and ComFrame separate and apart. The FSB's most recent actions have, in effect, rendered those attempts futile, as it (the FSB) has now merged them all as part of the G-SII measures."

Leonardi also raised questions on the FSB's designation of G-SIIs: "The IAIS published a paper in 2012 that essentially concluded that traditional insurance does not cause or transmit systemic risk, and we still support that conclusion. We continue to believe that traditional insurance activities are not systemically risky. To designate any number of companies as systemic without the IAIS as the international standard setter for insurance, having the opportunity to complete a thorough comparability study is like throwing darts at the numbers on a dartboard to determine how many companies should be designated."

Leonardi said the IAIS “urged that a comprehensive comparison of G-SIIs with the 29 systemically important banks be conducted to assess the threat posed by potential GSIIIs relative to financial firms in other sectors. In other words, understanding whether the most systemically risky insurer (by virtue of its nontraditional or noninsurance activities) is still less risky than the least systemically risky bank, is relevant before making a designation and recommending additional requirements that will bifurcate the market.”



Deloitte’s Howard Mills and colleague John Corston shared applicable lessons from bank resolution procedures with insurance regulators.

He spoke of concerns U.S. regulators have as they contemplate regulating those companies designated G-SII: “Despite having the largest number of GSIIIs within our jurisdictions, U.S. state insurance regulators have little insight into the deliberations at the FSB, so it is unclear whether other information in addition to the relative ranking done at the IAIS work was considered. Mitigating systemic risk is an objective all financial regulators share, but given the impact of this effort on financial firms and their customers and the potential for an unlevelled playing field in otherwise competitive and healthy insurance markets, it is important to get this right.”

The FSOC did not fare much better in regulators’ assessments. The naming by that organization of U.S. SIFIs meant, according to FSOC non-voting member and regulator representative Commissioner John Huff of Missouri, that to some, the FSOC still did not understand the insurance business model.

Former FDIC Associate Director and current Deloitte Director John Corston and former New York Insurance Superintendent and current Deloitte Director Howard Mills presented to the Task Force on banking resolution procedures and what that may mean for insurers as procedures are developed for SIFIs as required under Dodd-Frank.

“Applying the existing guidance from the FSB as a proxy... it is likely that the content of recovery and resolution plan submissions...will comprise many similar components to those submitted by banking institutions,” the Task Force was told.

# Reinsurance collateral reductions are almost here

Reinsurance collateral requirements for non-U.S. reinsurers has been seen as both a major issue and the low hanging fruit in discussions between United States and foreign, primarily European, regulators. The NAIC took a major step forward at the meeting of the Reinsurance (E) Task Force when it adopted the Process for Developing and Maintaining the NAIC List of Qualified Jurisdictions.

Reinsurers licensed and domiciled in these qualified jurisdictions will be eligible to be certified by states as certified reinsurers, with corresponding reductions in collateral requirements. So far, four jurisdictions have been approved by individual states: Bermuda, Germany, Switzerland and the United Kingdom.



Pennsylvania Commissioner Michael Consedine shepherded the reinsurance jurisdiction qualification process through the NAIC.

*Photo courtesy of the NAIC*

In a statement issued by the NAIC, Michael F. Consedine, Chair of the Task Force and Pennsylvania Insurance Commissioner, said, "We hope to have these jurisdictions approved as conditional qualified jurisdictions before the end of the year. We look forward to working with regulators from these jurisdictions, as well as the Federal Insurance Office and other federal authorities interested in this process."

In the same statement, NAIC President and Louisiana Insurance Commissioner Jim Donelon said, "The reduction of reinsurance collateral requirements has been a priority for the NAIC and the states for more than a decade, and the adoption of this process brings us closer to achieving this goal."

Task Force Vice Chair, Missouri Director of Insurance John Huff said that 18 states have enacted provisions to implement the Revised Credit for Reinsurance Models. Primary insurers in those states write approximately 53% of U.S. insurance premiums. By the end of 2014, Huff said, insurers writing 70 to 75% of U.S. insurance premiums should be in states that have enacted provisions of the model. So far, 29 reinsurers have been certified in New York, Connecticut and Florida, Huff said.

Pennsylvania regulator Steve Johnson, who heads the Reinsurance Financial Analysis (E) Working Group (FAWG), told the Task Force that the Reinsurance FAWG will examine the 29 companies certified thus far throughout the fall, then will move on to new applicants. The goal is to complete the review by the end of 2013, so companies can proceed with reduced collateral beginning on January 1, 2014.

Johnson said the peer review will cover the due diligence conducted by the lead filing state. After the peer review was completed, other states could then certify reinsurers on a passport basis. The lead filing state will notify the company of its status after the review in order to maintain confidentiality.

Next year, Johnson said, the Reinsurance FAWG will examine how to monitor and review the process. It is expected that the certification process will normally be done annually.

Consedine noted that talks between regulators in the United States and the European Union are "keenly focused" on reinsurance collateral. But in perhaps the major development at the Task Force meeting, Consedine pronounced Johnson the "NAIC equivalent of Justin Timberlake."

Fortunately perhaps for the assembled audience, Johnson merely laughed heartily at the announcement, neither attempting to dance nor to sing.

# PBR Implementation Task Force adds to plan, rejects request on captives

With PBR for life companies both a major focus and bone of contention for the NAIC, its Principle-Based Reserving Implementation (EX) Task Force under the direction of Tennessee Commissioner Julie Mix McPeak moved the process along by appointing a PBR Review (EX) Working Group, to be chaired by Mike Boerner of the Texas Department of Insurance. The mission of Boerner's Working Group is to coordinate financial analysis, examination, and actuarial review procedures.

The Task Force also added a suggested revision to its implementation plan while declining to take action on a request to reconsider a charge on captives. In addition, the Task Force heard a presentation on data collection and dissemination costs incurred thus far.

The Task Force discussed the policy data collection and dissemination process. New York, now being joined by Kansas, has carried out the process on the NAIC's behalf up until now. According to the NAIC, approximately 55 companies have been submitting data to New York since 2010, representing roughly 40% of the subject premium from direct writings and reinsurers in the entire U.S. market. With the companies that will report to Kansas, approximately 70-80% of life insurance premium collected nationwide will be represented in the data.

New York told the Task Force that costs for its project had been about \$2 million annually, all borne by New York companies. This covered life mortality data, and could be expected to increase as additional data, including lapse data, policyholder behavior, expense data, and data for long term care and others are added. New York companies should not be expected to bear the entire burden, New York's Mike Maffei told the Task Force.

Kansas joined in telling the Task Force that handing the statistical agent project over to the NAIC would help spread costs and achieve better coverage.



California Commissioner Dave Jones had an instruction to hire modeling specialists added to the plan.

*Photo courtesy of California Department of Insurance*

California Commissioner Dave Jones, who in previous meetings had expressed concern about the availability of modeling specialists, presented a letter to the Task Force requesting a revision to the PBR Implementation Plan to indicate "the NAIC and states should also retain computer modeling specialists in order to oversee and test reserve calculations within PBR models." A motion supporting the revision was made and passed unanimously.

Delaware requested the Task Force reconsider a charge of the proposed Captives (EX) Working Group that it thought discouraged the formation of affiliated captives. During the discussion, Delaware sought guidance on what to do if the charge remained in contravention of its mission to encourage such captive formation. New York suggested Delaware cease forming affiliated captives for certain types of transactions. Delaware declined to accept that suggestion, and with no Task Force action, the conundrum remains.

# Group supervision ICP changes causing agita

Insurance Core Principle (ICP) 23 on group-wide supervision is being temporarily delinked from ComFrame, NAIC staff told the Group Solvency Issues (E) Working Group. Group supervision has been an important but tense issue for international regulators, and the IAIS is currently rewriting ICP 23.

The IAIS began the review of ICP 23 related to group supervision in February because of comments received during the 2012 self-assessment review undertaken by the IAIS member jurisdictions. The ICP 23 drafting group has been merged with the IAIS group that worked on the Joint Forum Principles.

The group has begun by removing from ICP 23 items that duplicate other ICPs. This was a concern because during the Financial Sector Assessment Program (FSAP) process, countries were being marked down twice for the same deficiency. The rewrite of the other ICPs has been completed and those new drafts will be presented to the various IAIS subcommittees for review in September. Then they will be submitted to the Technical Committee in October. If approved, then there will be a public consultation period beginning in October.

Staff told the NAIC Working Group that the FSB wanted direct supervision at the holding company level and was exerting clear pressure on the IAIS, and that it could turn out that indirect approaches might become incompatible with ICP 23.

That raised a question for regulators as to whether the FSB was now the real regulator of insurers worldwide. Another question raised involved the limits of state insurance regulators' power. One speaker asked what would happen with a well-known Japanese electronics conglomerate that happen to own an insurer. Where would ICP 23 define the holding company there? The answer is as yet unclear, but staff suggested that it seemed there was more and more agreement that there should be direct authority over the holding company, though that may be at the insurance holding company level.

One industry representative noted that aside from group capital, ICP 23 would have the greatest effect on U.S. insurers. That raised questions as to how U.S. insurer

regulation could be affected. What if, for example, a U.S. insurer was part of a group under a Delaware-headquartered holding company and protected by that state's laws? How would insurance regulators assert their authority? Regulators noted that would raise McCarran-Ferguson issues as to whether insurance regulators could regulate a holding company not involved in the business of insurance.

Concerns were expressed as to whether the potential wording of the ICP by the IAIS would satisfy the FSB. The involvement of the FSB, which had earlier been criticized for its lack of transparency, could be regarded as clear evidence that the FSB was getting involved with internationally active insurance groups, one speaker said.

Staff told the Working Group that ICP 23 will not be included in the final October exposure draft of ComFrame although the IAIS had previously said it would. ComFrame will have its own language.

The Working Group also received an update on IAIS Joint Forum initiatives from Rob Esson of the NAIC. Mr. Esson stated the Joint Forum released a paper on mortgage insurance, as well as a consultation paper on longevity risk transfer markets that regulators and interested parties should read. The Joint Forum will also continue efforts on work streams related to Point of Sale Disclosure and Asset Encumbrance.

The Working Group approved a motion to refer proposed changes to the NAIC Financial Analysis Handbook related to the roles and responsibilities of the U.S. lead state and U.S. group-wide supervisor to the Financial Analysis Handbook (E) Working Group. The motion included some minor revisions to the document, including the removal of the 'Sample Confidentiality Agreement' for Supervisory Colleges, as regulators stated confidentiality agreements are structured for the unique needs and circumstances of the jurisdictions within each college. The Working Group also agreed to post the Lead States on the NAIC website.

Lastly, the Working Group discussed a proposed letter to the Financial Examiners Coordination (E) Working Group related to group-wide examinations, but deferred action until after the 2013 ORSA Pilot project is completed.

# Reinsurance credit, asset risk charges for P-C companies being reviewed

Asset risk issues and possible changes to the reinsurance credit risk charge will stay tops on the agenda of the Property and Casualty Risk-Based Capital (E) Working Group for the near future. A trade group asked the Working Group to revise its reinsurance credit risk charge, while regulators discussed the need to review and possibly update investment risk charges for property-casualty companies.

Nicole Elliott of the Texas Department of Insurance told the Working Group it was time to look at R1 and R2 asset risk issues given that life regulators are looking at updating their investment risk information. The C-1 Factor Subgroup, which covers asset risks on the life side, indicated there was an issue, she said, and now the investment risk review will extend to property-casualty companies.

Investment issues to be addressed include:

- Having an asset valuation reserve for property-casualty companies;
- Beta adjustment for common stocks and other long-term assets (as life insurers currently have);
- Differentiation of Schedule BA assets to be considered. Life companies have a lot more differentiated assets on that schedule and different factors, but property-casualty companies now have just a straight charge;
- Life Mortgage Experience Adjustment Factor (MEAF) changes may mean property-casualty companies should look at their risk charges for commercial mortgages as well; and
- Municipal bonds may be modeled and factors determined.

One industry representative cautioned against making changes that may require system investments while having no real effect on outcomes. Things that may be material and worth the cost to a life insurer may not be worth it to a property-casualty insurer, the representative warned.

The Reinsurance Association of America (RAA) presented its discussion draft of a proposal for revising the property-casualty R3 RBC factor for reinsurance credit risk. Currently, there is a 10% charge on reinsurance recoverables in the R3 RBC factor and the RAA has long argued that that factor is too high, and is actually four to seven times higher than the credit risk factors used by Standard & Poor's for an A rated reinsurer.

The RAA representative suggested that the 10% R3 factor should be decoupled from the contingent reinsurance credit risk charge (R6 and R7). Because the one-in-100 year loss level calculated in R6 and R7 is a much higher stress scenario than currently used in R3. The RAA said its highest priority was to request a decoupling of the 10% charge and a lowering of the factors for R6 and R7.

Under the RAA's plan, reinsurer financial strength and collateral offsets would be considered in determining the risk charges.

One regulator agreed that it made sense to vary risk charges by the rating of the reinsurer and by any underlying collateral. An industry representative voiced concerns, saying the surplus may be hit twice under the RAA proposal. The representative said additional bad debt reserves and additional penalties for slow pay were already captured in the surplus. If these were also pushed into the RBC formula as it would implicitly be using the rating as a base, surplus would be hit twice.

The representative also added that this proposal would increase reliance on rating agencies, and the NAIC as well as rating agencies had already agreed that these agencies should be simply one data point amid a whole slew of analyses.

Discussing the proposal, Texas's Elliott said, "I think that we ought to do something that's risk-based...I think we ought to account for collateral."

# State surveys say auto insurance market is competitive

Numerous presentations to the Auto Insurance (C/D) Study Group all seem to point to the same conclusion: the current auto insurance market is relatively competitive and does not seem to disadvantage low-income and underserved communities.

The Study Group was told seven states had conducted inquiries or hearings on the issue. Three states have shown an increase in the residual market while 18 states have shown a decrease in the numbers in the residual markets, normally a sign of a competitive voluntary market.

Thirty-two states have processes in place to identify uninsured motorists, but only three states had data that would allow them to identify underserved communities.

The NAIC has focused on issues surrounding auto insurance and underserved and low-income communities partly as a result of numerous consumer group studies that have posited that the auto insurance market discriminates unfairly against these communities. The Federal Insurance Office has also been charged under Dodd-Frank with investigating the impact of the current auto insurance market on low-income and underserved communities, but its report is not yet available.



Speak softly and carry two big sticks? Indiana Commissioner Stephen Robertson, center, presented NAIC President Jim Donelon, right, and CEO Ben Nelson, left, with bats made by Indiana's Hoosier Bat Company.

*Photo courtesy of the NAIC*

# Corporate Governance enhancement measures move forward

“Vermont Strong” was more than just a bumper sticker slogan at the meeting of the Corporate Governance (E) Working Group as its chair, Vermont Commissioner Susan Donegan kept the Corporate Governance Model Act rolling merrily along on the fast-track to adoption.

After the Working Group approved the addition of board management and oversight of an organization’s market conduct decision-making process to the critical risk areas to be included in the Model Act, Commissioner Donegan said she expected a draft to be ready for the winter NAIC national meeting.

“It represents what we have been working for...Trying to find some common ground,” she said. “We want to get this thing moving.”

Industry representatives submitted a proposed model that largely tracked that proposed by the Working Group. While that indicated a willingness to cooperate with the Working Group, industry representatives also made clear their expectation that acceptance of this new Model Act by industry would also mean the removal of redundant regulatory requirements.

“It is vital to the industry that we remove redundant filing requirements,” one industry representative said.

Another industry representative agreed, “What we don’t support is this being one more layer of redundant information flowing from industry to regulators...It’s really not the information we mind having to get to you. It’s having to give it to you multiple, multiple times.”

One industry representative summed up the industry requirements for support as including the reduction of redundant information requests and the lack of any comparative analysis in the proposal.

While the effective date of this Model Act is yet to be decided, Pennsylvania regulator Steve Johnson suggested an effective date of January 1, 2016. That would follow by one year the effective date of the Own Risk and Solvency Assessment, and would mark another milestone in the NAIC’s implementation of its Solvency Modernization Initiative (SMI).



A record 35 state legislators joined regulators at the Indianapolis NAIC meeting.

*Photo courtesy of the NAIC*

# Issues raised with contracts exposure drafts



NAIC CEO Sen. Ben Nelson listens intently as Louisiana's Insurance Commissioner and NAIC President Jim Donelon spoke at the opening session.

*Photo courtesy of the NAIC*

The International Solvency and Accounting Standards (E) Working Group heard presentations from the ACLI and the U.S. P&C Coalition on the IASB and Financial Accounting Standards Board (FASB) insurance contracts exposure drafts.

The ACLI stated that three key issues with IASB exposure are complexity, convergence and costs. Specifically, notable differences between IASB and FASB, included: treatment of acquisition costs; change in estimates reported immediately in net income versus adjusting service margin; bifurcation of cash flows for certain contracts; having risk adjustment and service margin (IASB) versus a single service margin (FASB). ACLI also noted one reinsurance related issues, stating the IASB proposal will require offsetting ceding commission against premium unless related to actual experience, which could result in reinsurance accounting not aligning with direct business.

The U.S. P&C Coalition stated the IASB proposal was a fundamental change in accounting and reporting as insurers know it today and described several issues. One issue was

related to the IASB forcing portfolio accounting when P&C insurers' investments don't always track with liabilities. One industry representative said that all health premiums under the Affordable Care Act could be considered loss sensitive and would disappear.

The Working Group also briefly discussed an NAIC staff draft of key issues relating to the IASB exposure and agreed to meet again by conference call in early September to finalize the document prior to regulators and NAIC staff attending the upcoming IAIS Accounting & Auditing Issues Subcommittee meeting in mid-September and early October.

Lastly, the Working Group received a brief update on the IAIS Field Testing Task Force, which will meet in member-only session in Washington, D.C. on September 5. Two hours were open for observers. The RAA monitored the meeting. The update also mentioned that the first questionnaires to participating supervisors and IAIGs would be around March 2014.

# “A” Committee says goodbye to annuity disclosure group



Oklahoma Insurance Commissioner John Doak and NAIC CEO Sen. Ben Nelson share a moment at the NAIC reception.

*Photo courtesy of the NAIC*

Although life insurance issues such as principle-based reserving dominated the NAIC national meeting, the meeting of the Life Insurance and Annuities (A) Committee was a remarkably sedate affair. The highlight of the Committee meeting may well have been the requested dissolution of one of its working groups.

“I believe the working group has met all of its charges,” said Iowa’s Jim Mumford of the Annuity Disclosure Working Group. “I ask that we be relieved of our duties.” The Working Group had been charged with creating an annuity buyers guide, and that guide has now been completed.

The Committee also discussed and approved provisions of the proposed charges for NAIC groups that will be working on issues identified in the report of the Contingent Deferred Annuity Working Group. Both the ACLI and the Insured Retirement Institute (IRI) offered proposed revisions to the charges. After discussion and revisions to the revision by regulators, the proposals were accepted.

Consumer groups continued their campaign against contingent deferred annuities (CDAs). The Center for Economic Justice called CDAs “a dangerous product for consumers,” and requested that the NAIC charge “a new working group to identify potential consumer protection issues associated with CDAs and make recommendations for consumer protection requirements related to the sale and administration of CDAs.”

# SMI white paper adopted

The Solvency Modernization Initiative (E) Task Force adopted the Solvency Modernization Initiative (SMI) White Paper: *The U.S. National State-Based System of Insurance Financial Regulation and the Solvency Modernization Initiative*, but noted that it should be considered a living document and updated regularly when needed. The Task Force also adopted its three working group reports after receiving brief key updates.

The Task Force discussed creating a “SMI dashboard” and/or “State Adoption Maps” to track the adoption of SMI related new or revised model laws and regulations by states, including the Insurance Holding Company System Regulatory Act; the Insurance Holding Company System Model Regulation with Reporting Forms and Instructions; Risk Management and Own Risk and Solvency Assessment Model Act; Standard Valuation Law.

The Chair mentioned the Task Force’s life span would likely continue through 2013, however remaining Working Group items could be overseen by the Parent Committee during 2014.



Louisiana Insurance Commissioner welcomed almost two thousand attendees to his second meeting as NAIC President.

*Photo courtesy of the NAIC*

# In brief

## **RRGs to get Form F**

Risk Retention Groups should have to file the Form F: Enterprise Risk Report, the Risk Retention Group (E) Task Force decided unanimously at its Indianapolis meeting. The Task Force had reviewed 2010 changes to model acts and regulations governing insurance holding companies with an eye to seeing if the significant elements should apply to risk retention groups.

## **Regulators support TRIA renewal.**

As expected, the NAIC voted to endorse the reauthorization of the Terrorism Risk Insurance Act (TRIA). TRIA, was enacted after the 9/11 attacks in order to provide affordable terrorism coverage to businesses. The latest authorization expires at the end of 2014.

## **Lender-Placed Insurance data request**

With settlements and possible abuses of Lender-Placed Insurance (LPI) still in the news, Alabama Commissioner Jim L. Ridling told the Property and Casualty Insurance (C) Committee that he would like to see some data showing

changes in policy counts in order to be able to monitor the state of the LPI market. Ridling also sought to get information on in-force premiums for new business. C committee Chair Mike Chaney of Mississippi noted that the Committee has been working with the Federal Housing Finance Agency (FHFA) on LPI. Among other issues, Cheney noted the FHFA is seeking to outlaw commissions on LPI.

## **Title insurance guaranty fund coming?**

The Title Insurance Guaranty Fund (C/E) Working Group has exposed possible new title guaranty fund guidelines that would either create a guaranty fund as part of a larger property-casualty guaranty fund or create a separate guaranty fund for title insurers. The Working Group will receive and review comments during its fall conference calls. The Title Insurance (C) Task Force also formed a new working group to review consumer issues relating to shopping for title insurance. Kansas and Ohio will co-chair the Consumer Shopping Tools (C) Working Group.

# Actuarial update

## Life Actuarial Task Force (LATF)

Activities for amendment of the PBR Valuation Manual continue while the associated new Standard Valuation Law (SVL) is being considered for adoption by the legislatures. This includes refinements of core existing sections (such as VM-20), and continued drafting of proposed new sections (such as VM-22)

Following are highlights from LATF activities from the Summer 2013 NAIC Meeting:

### Life PBR (VM-20)

Work continues on refinements to the Life portion of the Valuation Manual from LATF members, the American Academy of Actuaries (AAA) and industry interested parties (such as the ACLI). Notable items addressed included the following:

- Allow Letters of Credit (LOCs) to be counted as assets in reserve calculations, as long as the LOC is considered an admitted asset on the balance sheet. Associated LOC fees are to be included in reserve calculation cash flows as well;
- Propose that small companies (defined as annual premiums less than \$500 million) have a longer PBR transition period (5 years instead of 3 years);
- Provide for an alternative method for calculating the deterministic reserve under PBR known as "Direct Iteration Option" in which the reserve would equal the statement value of starting assets that fully liquidate the liabilities for a block of business; and
- Propose that individually underwritten group contracts be included in the scope of VM-20, preventing a possible "loophole" for avoiding VM-20 requirements.

### New morality tables

The American Academy of Actuaries (the Academy) gave an update of the mortality work being performed by the Society of Actuaries (SOA) and Academy toward developing the 2014 VBT/CSO mortality tables and tables for PreNeed and Simplified Issue products.

The 2014 VBT (industry experience) tables are close to being finalized, with work on the 2014 CSO expected to commence this fall. The 2014 CSO Table will be based on the VBT and include a margin, and will be used for the Net Premium Reserve (i.e. "floor reserve") calculations under PBR, and for non-forfeiture and tax reserve purposes.

Work on preneed and simplified issue studies continues as well concurrent with the VBT/CSO work. Compiling of tables is expected to commence in the fall as well.

### AAA Aggregate Margin Subgroup

The Academy's Aggregate Margin Subgroup presented a report discussing the elimination of individual margins in PBR in favor of an aggregate margin approach. The report presents discussion and supporting research for several aggregate margin approaches including a Conditional Tail Expectation (CTE) approach (used in AG 43 and C-3 Phase II) and a cost of capital approach.

LATF voted to expose the document and will continue to discuss the alternatives on subsequent conference calls. Concurrently work will continue with the Academy subgroup based on LATF and interested party feedback.

### General Account Annuity PBR (VM-22) Subgroup

The general account annuity (VM-22) subgroup provided another update on activities toward drafting PBR requirements for fixed deferred and payout annuities (i.e. "general account annuities"). Highlights included updates on AAA working group activities and a field test by the Kansas DOI on two companies testing methods using the AG 33/43 standard scenario and new methods proposed in VM-22. The Kansas actuary (Mark Birdsall) expects to present results of the field test at the Fall 2013 NAIC Meeting.

### PBR Experience Reporting (VM-50/51)

The experience reporting (VM50/51) subgroup provided another update on the experience reporting process with the New York and Kansas pilot programs and the anticipated NAIC process. Based on the LATF exposure for a data collection format on some policyholder behavior, the group plans to collect lapse data on ULSG and term policies in 2014. Subsequently, additional data will be collected, including other policyholder behavior data and possible expense data.

*The actuarial update was prepared by Russell Menze.  
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# Health update

## **Health Care Reform Regulatory Alternatives (B) Working Group (“Working Group”)**

A meeting of the Working Group was held on August 25, 2013 at the NAIC national meeting in Indianapolis, Indiana. The charges of this Working Group are outlined below.

### **2012 Charges of the Working Group**

The Working Group was formed at the NAIC Summer Meeting with the goals of:

- Providing a forum for discussion of and guidance on the alternatives to implementing a state-based exchange and the implications of such alternatives on regulatory authority;
- Resolving open issues that need to be addressed with regard to non-state exchange ACA alternatives; and
- Analyzing the impact of the ACA on existing regulatory authority both inside and outside of a federal exchange, as well as the impact on NAIC Model Laws and identifying opportunities for NAIC members to continue to innovate and regulate outside of a federal exchange.

There were representatives from several states, all of which will have a Federally-Facilitated Marketplace, (“Marketplace”) that provided an update of their efforts to move forward with educating as well as informing their residents on the Affordable Care Act (“ACA”).

## **Kansas**

The state of Kansas has created a website, specifically [www.insureKS.org](http://www.insureKS.org), which will provide residents of the states with an interactive process for learning about the ACA as well as a cost estimator for determining the costs of products and what subsidiaries are available for them. They noted that since there is no Medicaid expansion in Kansas, residents whose income is below the Federal Poverty Level (“FPL”) will not receive a subsidy.

## **Missouri**

The state of Missouri has established a “Cover Missouri” coalition in light of the constraints of state employees being involved in federal health reform initiatives. It should be noted that recent legislation will allow the Department of Insurance to regulate products on the marketplace but their involvement in other aspects of the ACA will be minimal. This coalition has developed a website that will be officially launched on August 27, 2013 and will provide residents with accessing the names of people, such as navigators, that can provide assistance with gaining a better understanding of the ACA as well as determining what is available to meet their healthcare needs. There was an acknowledgement that due to the lack of Medicaid expansion in Missouri, residents with low income would be challenged to find affordable health care products.

## **Pennsylvania**

The state of Pennsylvania has also developed a website for residents to learn about the ACA, as well as the private market options. The website, which is [www.PAhealthoptions.com](http://www.PAhealthoptions.com), will also have links to community based services. They have also created a unit within the Department of Insurance, currently employing five people, who will respond to inquiries from residents about health care related questions. Pennsylvania received a grant of \$34 million from the U.S. Department of Health & Human Services in 2012 to work on establishing a state based Exchange. Since the state has a Marketplace, they are unclear as to how they can use the remaining funds under this grant to address issues relating to the ACA in their state. They reached out to HHS to inquire as to whether the funds from the grant could be used for the website and for consumer education for residents but no definitive response has been received to date. They were advised that among the concerns of HHS is ensuring that efforts in a state are not duplicative. Pennsylvania is also forming public/private partnerships with entities in rural areas since the Marketplace may be primarily providing ACA information in the Philadelphia and Pittsburgh areas.

## **Nebraska**

The state of Nebraska also received a grant from HHS and has been in discussions with HHS as to how they can use those funds since they will have a Marketplace. Nebraska has already informed HHS that they used some of those grant funds to begin creating a website for residents to learn more about the health options available in Nebraska. The state has also not received any definitive response from HHS as to how they can use the remaining grant funds.

## **Wisconsin**

The state of Wisconsin also does not have an expansion of Medicaid and their focus is currently on assisting the population that fall between 100-200% of the FPL, which is estimated to be approximately 92,000 residents. They have been providing education to agents and navigators in their state on Medicaid, while also requiring navigators to be subject to substantially similar requirements of agents in the area of licensing and continuing education, among other areas. The state is also planning to establish regional enrollment networks and is working closely with the Wisconsin Department of Health Services to enhance the outreach of these enrollees.

## **Montana**

The state of Montana has established a website at [www.MontanaHealthAnswers.com](http://www.MontanaHealthAnswers.com) which is intended to provide information on the ACA but allow provide a venue for residents to submit questions to the Department of Insurance. There does not appear to be any "rate shock" for the 2014 enrollment so the state is encouraging residents to review the information on the website prior to considering early renewal for 2014. The state will also be posting the names of people/entities who will be allowed to act as navigators or Certified Application Counselors to minimize any potential for fraud in this area.

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# Accounting update

This section of the NAIC Update focuses on accounting and reporting changes adopted and exposed during the 2013 Summer Meeting. The deadline for submitting comments on items exposed is October 10, 2013 (except for Ref #2012-33 (Title Insurance) and #2013-10 (Working Capital Finance Investments) for which the deadline is September 13, 2013, and Ref# 2013-17 (Real Estate LLC) which is November 22, 2013.

## Statutory accounting principles working group

**Current developments:** The SAPWG adopted the following non-substantive amendments as final during the Summer Meeting:

Reference	Title	Sector	Amendments adopted as final	Financial statement impact	Disclosure	Effective date
2011-45	SSAP No. 62R – Property and Casualty Reinsurance	P&C	Nonsubstantive Change – Adopted revisions to change the provision for reinsurance on Schedule F for certain retroactive reinsurance contracts on asbestos and environmental risks (in situations when the collection risk for third party reinsurance contracts has been duplicated and secured by the counterparty when a novation or assignment has not occurred).	Y	N	2014
2013-02	SSAP No. 92 – Accounting for Postretirement Benefits Other than Pension	P&C Life Health	Nonsubstantive Change – Adopted with modification EITF 06-04, Accounting for Deferred Compensation and Postretirement Benefit Aspects of Endorsement Split-Dollar Life Insurance Arrangements, which specifies that endorsement split-dollar life insurance contracts do not settle the liability for postretirement benefit obligations (to avoid a double charge to surplus for the cash surrender value).	Y	N	2014
2013-04	Rejected GAAP Pronouncement	P&C Life Health	Rejected ASU 2013-02, Comprehensive Income – Reporting of Amounts Reclassified Out of Accumulated Other Comprehensive Income as not applicable to statutory accounting.	N/A	N/A	
2013-05	Various superseded SSAPs and INTS	P&C Life Health	Adopted revisions to remove superseded SSAPs and nullified INTS from the printed version of the Accounting Practices and Procedures Manual, effective with the 2014 version, and instead include them on the password-protected Web page for updates to the manual. Appendix H will still be included in the CD-ROM Folio version of the manual.	N/A	N/A	2014
2013-06	SSAP No. 100 – Fair Value Measurements	P&C Life Health	Rejected ASU 2013-03, Financial Instruments: Clarifying the Scope and Applicability of a Particular Disclosure to Nonpublic Entities, for statutory accounting (as guidance for reporting fair value and the corresponding fair value hierarchy is already required in SSAP No. 100 for all reporting entities).	N/A	N/A	
2013-07	SSAP No. 64 – Offsetting and Netting of Assets and Liabilities SSAP No. 86 – Acct. for Derivatives and Hedging Activities SSAP No. 103 – Acct. for Transfers and Servicing of Fin. Assets	P&C Life Health	Revisions reject ASU 2013-01: Clarifying the Scope of Disclosures about Offsetting Assets and Liabilities, incorporate guidance clarifying derivatives, repurchase and reverse repurchase agreements, and securities borrowing and securities lending transactions can be reported net on the balance sheet when a valid right to offset exists, and adds disclosures to illustrate the netting impact. The revisions do not change the gross reporting requirements for specific schedules (e.g., Schedule DB).	N	N	2014
2013-08	SSAP No. 40 – Real Estate Investments	P&C Life Health	Nonsubstantive Change – Revisions adopted to clarify the definition of “encumbrances” for accounting for “participating mortgage loan liabilities” (i.e., when the lender participants in the appreciation).	N	N	2014
2013-16	SSAP No. 43R – Loan-Backed and Structured Securities	P&C Life Health	Nonsubstantive Change – Revisions to incorporate guidance for interim financial statements for RMBS and CMBS acquired subsequent to year-end to, in certain circumstances, allow use of either prior-year modeling data or analytical procedures to value such securities (	N	N	2014

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The SAPWG exposed the following items for written comment by interested parties – three proposals are substantive (see Ref # 2011-38, 2013-10 and 2013-13 below) and all other proposals are categorized as nonsubstantive:

Reference	Title	Sector	Amendments adopted as final	Financial statement impact	Disclosure	Effective date
2011-38	SSAP No. 35R – Guaranty Fund and Other	Health	<p>Substantive Change – Revisions propose guidance to prescribe the process for recognizing a liability and corresponding expense for the new ACA assessment for 2014 and after. This guidance proposes to adopt, with modification, ASU 2011-06, Fees Paid to the Federal Government by Health Insurers. ASU 2011-06 recognizes the liability in the year the fee is paid. The modifications propose to: 1) nonadmit the deferred expense; and 2) segregate surplus in the data year for the amount payable in the fee year.</p> <p>In addition, the Working Group directed the NAIC staff to prepare and release for discussion an analysis of how the exposure draft aligns with the SAP Statement of Concepts, and then to proceed with an IP to document discussion of the proposed guidance, with supportive and alternative views.</p>	Y	Y	2014
2013-03	SSAP No. 104 – Share-Based Payments	P&C Life Health	<p>Substantive Change – Exposed Issue Paper No. 146 – Share-Based Payments with Non- Employees, which proposes to substantively revise SSAP No. 104 and adopt, with modification, guidance reflected in Accounting Standards Codification 505-50 – Equity, Equity Payments to Non-employees. Interested parties confirmed that share-based payments to non-employees are applicable to some companies.</p>	Y	N	2014
2013-10	New SSAP – Working Capital Finance Investments		<p>Substantive Change – Exposed a proposed SSAP to allow working capital finance investments to be admitted assets if specific criteria are met (e.g., SVO must rate the program, one year maturity or less, annual report on internal controls without material weaknesses, waive defense of payment, etc.).</p>	Y	N	2014
2012-33	SSAP No. 57 – Title Insurance		<p>Nonsubstantive Change – Revisions propose clarifications to the loss reserve calculation recommended by the Title Insurance Financial Reporting (C) Working Group.</p>	N	N	2014
2013-15	SSAP No. 43R – Loan-Backed and Structured Securities	P&C Life Health	<p>Nonsubstantive Change – Revisions propose to limit the disclosure for bifurcated other-than-temporary credit impairments to items recognized in the current reporting period. Comments were requested on the possibility of including a cumulative disclosure with the current period activity.</p>	N	Y	2014

Reference	Title	Sector	Amendments adopted as final	Financial statement impact	Disclosure	Effective date
2013-17	SSAP No. 40 – Real Estate Investments	P&C Life Health	Nonsubstantive Change – Exposed agenda item to requests information regarding a proposal to allow real estate held in a LLC to follow the guidance in SSAP No. 40 rather than the guidance in SSAP No. 48 – Joint Ventures, Partnerships and Limited Liability Companies if specific criteria is met. The Working Group also sent a referral to the Capital Adequacy Task Force to obtain comments on the RBC impact of the proposal.	Y	N	2014
2013-18	SSAP No. 5R – Liabilities, Contingencies and Impairments of Assets	P&C Life Health	Nonsubstantive Change – Revisions propose to adopt, with modification, ASU 2013-04, Obligations Resulting from Joint and Several Liability Arrangements for Which the Total Amount of the Obligation is Fixed at the Reporting Date.	Y	N	2014
2013-19	Rejected GAAP Pronouncement	P&C Life Health	Exposed nonsubstantive revisions to reject ASU 2013-07, Liquidation Basis of Accounting as not applicable to statutory accounting.	N/A	N/A	N/A
2013-20	SSAP No. 68 – Business Combinations and Goodwill	P&C Life Health	Nonsubstantive Change – Exposed revisions to clarify that the elimination of goodwill when the investee ceases to exist applies to both statutory purchases and mergers, and that internally generated goodwill and goodwill of the reporting entity in itself are not permitted.	Y	N	2013
2013-21	SSAP No. 26 – Bonds, Excluding Loan-backed and Structured Securities	P&C Life Health	Nonsubstantive Change – Revisions propose to clarify amortization requirements for bonds with make-whole call provisions and bonds that are continuously callable.	Y	N	2013
2013-22	SSAP No. 69 – Statement of Cash Flow	P&C Life Health	Nonsubstantive Change – Exposed revisions adopt, with modification, ASU 2012-05, Not-for-Profit Entities: Classification of the Sale Proceeds of Donated Financial Assets in the Statement of Cash Flows (Topic 230) and clarify that donated, use-restricted financial assets are nonadmitted.	Y	N	2014
2013-23 2013-24	Various SSAPs and references in APPM	P&C Life Health	<ol style="list-style-type: none"> <li>1. Revisions propose using “NAIC designation” instead of “NAIC rating” throughout the manual (including within AG 43).</li> <li>2. Revisions propose to rename the “Authoritative Literature” SSAP section to “References” and remove the GAAP references from this section (these revisions do not propose changes to authoritative guidance).</li> </ol>	N/A	N/A	2014
2013-25 2013-26	SSAP No. 101 – Income Taxes, A Replacement of SSAP No. 10 and 10R	P&C Life Health	<p>Nonsubstantive Changes –</p> <ol style="list-style-type: none"> <li>1. Revisions propose consistency changes related to previously adopted financial guaranty and mortgage guaranty realization threshold limitations.</li> <li>2. Revisions reflect an informational exposure to reject ASU 2009-06, Implementation Guidance on Accounting for Uncertainty in Income Taxes and Disclosure Amendments for Nonpublic Entities, and incorporate a definition of a “tax position”; and to reject FSP FIN 48-1 incorporate guidance for tax contingency settlement in SSAP No. 5R, and define a tax position in SSAP No. 101.</li> </ol>	N/A	N/A	2014

Reference	Title	Discussed – or received an update on – the following agenda items
2011-46 2013-14	SSAP No. 62R – Property and Casualty Reinsurance	<ol style="list-style-type: none"> <li>1. The Working Group moved agenda item #2013-14, Accounting for Portfolio Reinsurance Agreements between Affiliated Entities that Do Not Result in Surplus Gains, to the disposed listing in response to the sponsor’s request to withdraw.</li> <li>2. Discussed a referral from the Blanks Working Group advising of the deferral of proposal #2013-09BWG to allow concurrent consideration with agenda item #2011-46: Additional Reserve under Provision for Reinsurance, as the two items have opposing objectives.</li> </ol>
2012-15 2012-16	SSAP No. 65 – Property and Casualty Contracts	Received summary information on the number of responses from the survey administered to obtain market-relevant information for no cost/reduced cost extended reporting programs issued in the event of death, disability and retirement and policyholder loyalty programs. Additional analysis of the survey results will be completed.
2013-13	SSAP No. 86 – Acct. for Derivative Instruments and Hedging	Directed the NAIC staff to prepare an issue paper to consider accounting and reporting guidance for centrally cleared derivatives, including guidance for collateral and initial and variation margins. Regulators, as well as key industry representatives, involved in derivative transactions will be consulted.
2013-27	Reinsurance, Risk Adjustment and Risk Corridors under ACA	Addresses the temporary “reinsurance” program, risk corridors and risk adjustment that are all part of the Affordable Care Act. This item was moved to the substantive active listing, identified as a priority, with an interim exposure draft expected before the Fall National Meeting.
N/A	Restricted Asset Subgroup Update	Referred to the Working Group’s proposed accounting and reporting revisions for transactions with FHLBs. The Working Group exposed these proposed revisions on 8/19/13 with a comment deadline ending 9/13/13. The Subgroup will have an interim call to continue discussions on liquidity considerations for FHLB transactions (information on potential liquidity issues desired to be discussed are requested by 9/13/13).

# Emerging Accounting Issues Working Group

The Emerging Accounting Issues Working Group (EAIWG) exposed proposed revisions to reference INTs within applicable SSAPs. The exposed revisions intend to direct SSAP readers to the authoritative INT guidance in a more visual manner. The exposed revisions also recommend changes to update SSAP references included within the INTs in order to limit references to situations in which the INT provides a related and current interpretation. The deadline for submitting comments and new items is October 10, 2013.

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